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SUBJECT: Positive Chinese Reaction to Fannie Mae and Freddie Mac Action

REF: Hong Kong 1679

AmConsulate Shanghai contributed to this report.

¶11. (SBU) Summary: Chinese official and private reaction to news that the United States Government would place housing mortgage agencies Freddie Mac and Fannie Mae under conservatorship was generally positive. Vice Premier Wang Qishan appreciated the effort. Finance Assistant Minister Zhu Guangyao hoped to minimize the political cost to the Chinese government of the crisis. Stock market and business commentators also generally endorsed the move, while noting that most Chinese commercial entities are not overly exposed to Fannie and Freddie debt. End summary.

Official Central Bank Reaction

¶12. (U) The Chinese Central bank spokesperson today made a statement commenting on the U.S. government takeover of Freddie Mac and Fannie Mae. He said that "the People's Bank of China believes that these measures are positive and will stabilize the market and boost confidence." He added that "the U.S. government should conscientiously take responsibility for maintaining the stability of the global financial market and protecting the interests of investors."

Vice Premier Wang Qishan

¶13. (SBU) In a phone call with U.S. Treasury Secretary Henry Paulson, Vice Premier Wang Qishan said he appreciated the effort to protect both creditors and taxpayers. If creditors are not protected, he said, the international financial system would be adversely affected. Given that U.S. agency debt accounts for a large share of Chinese reserves, USG policies towards this debt greatly impacts China. He said he needs time to study the action and market reaction, and then will provide a response.

¶14. (SBU) Wang thought that 75 percent of GSE debt was held by U.S. investors. While China is the largest foreign investor, it only accounts for one-third of foreign-held agency debt. Wang stated that U.S., not Chinese, investors' reaction was critical. He said that if U.S. market confidence is not restored, it will be difficult for China to maintain confidence in this debt.

¶15. (SBU) Wang noted that the Chinese government does not want the U.S. economy to experience major problems. U.S.-China economic cooperation is strong. The USG policies on agency debt were a test of whether investors would be protected.

¶6. (SBU) Assistant Finance Minister Zhu Guangyao said that orderly and deft management of this problem is in China's interest. Zhu said that China holds USD400 billion in Freddie and Fannie assets. (Note: This is most likely based on June 2007 Treasury data, which reports Chinese holdings at \$376 billion. Actual holding are most likely higher because this does not include holdings in third country funds in which Chinese entities have invested, and Chinese overseas assets increased by USD 476 billion between June 2007 and June 2008.) Because the government faces a public opinion backlash associated with a loss in the RMB value of its foreign assets (both due to appreciation of the RMB and declines in the market value of its holdings) China wants to minimize the political costs of this crisis, said Zhu.

¶7. (SBU) Zhu noted that the United States had been telling the Chinese government for weeks that the tools provided by Congress were sufficient to handle the situation at Fannie Mae and Freddie Mac. He questioned why the USG had now turned to a conservatorship.

Market Reaction

¶8. (SBU) Shanghai Stock Exchange Deputy Director of Global Business Development Chao Kejian said that the takeover of Fannie/Freddie was very good news for China. China's banking sector stocks showed comparatively stable prices in wake of this news, even in the face of overall economic and

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property sector weakness.

¶9. (SBU) Chao speculated that the Central Government was slightly more likely to take measures to support China's stock market in the wake of the USG's action, but any such move would await a decision by Vice Premier Wang Qishan. The Central Government on balance is still very cautious about taking measures to support China's stock market.

Business Reaction

¶10. (U) Spokesman for the Bank of China Wang Zhaowen said "we think it's a very positive move by the United States government. It has come from being an invisible regulator to the front lines to save the market."

¶11. (SBU) Haitong Securities Macro Analyst Wu Yiping felt the U.S. government action would have little direct impact on the Chinese financial industry. Wu claimed that the banking sector has the largest exposure to Fannie and Freddie debt, although insurance companies such as Pingan and China Life Insurance might also hold some debt. She said Chinese investors saw the USG move as a positive signal for the global financial market.

¶12. (SBU) Bank of Communication Manager Chiu Gaoqing claimed that, although BoCOM had sold its Fannie and Freddie investments, and thus was not directly affected by the takeover, the move might bring some stability to global financial markets.

Commercial Exposure

¶13. (U) China Business News reports that, according to the latest survey by the China Banking Regulatory Commission (CBRC), at the end of June 14 banks held Fannie and Freddie debt valued at around USD31 billion, with the six listed commercial banks holding over USD25 billion in debt. The

Bank of China was the largest investor, with USD17.3 billion in debt.

¶14. (U) In the last month, all of the listed banks have announced that they are drawing down their Fannie and Freddie debt. Bank of China's Fannie and Freddie exposure decreased by around USD7.14 billion.

Comment

¶15. (SBU) The Chinese government's foreign exchange managers have recently received a fair amount of public criticism for taking large losses on Chinese foreign assets due to the appreciation of the RMB. The somewhat defensive call from the PBOC for the United States to "protect investors' interests" appears to reflect these attacks. While financial officials tend to acknowledge that Chinese international reserve holdings are too large for them to meaningfully adjust asset allocations without having significant and adverse market impacts on their holdings, this is not generally understood by senior officials and the general public. Government interlocutors have consistently stressed that, given the role of the US dollar as a reserve currency, the U.S. government has a responsibility to take into account any impact on the international financial system when addressing problems in government-sponsored enterprises. Thus, government finance officials seem genuinely appreciative that the U.S. government has acted to safeguard the interests of holders of Freddie and Fannie debt.

¶16. (SBU) Most Chinese commercial entities beyond the largest state-owned banks are not very exposed to U.S. agency debt. They nevertheless welcomed the USG move to stabilize international financial markets, given concerns that financial stress could further weaken the growth of U.S. domestic demand and Chinese exports.

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